DOW THEORY LETTERS INC.

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THE MARKET: The rally from the March 15 lows has continued far enough to qualify as a full correction of the February-March drop. As of April 11 the recovery had lasted four weeks; it had recouped 41% of the Industrials losses, 67% of the Rail losses.

Informed investors across the nation are asking themselves this question, "Is the rally the beginning of a new bull movement which will take the Averages above the highs, or is this a deceptive rally in a bear market, a bear market which started at the February 9 peak?" Many intelligent arguments are advanced on both sides. Bulls note that debit and credit balances have risen to new highs, they note that the short interest is still high, they point to the continued speculative interest in the market and to the fact that the economic boom shows no obvious signs of weakening. Bears argue that bank credit statistics have turned sour, that the Industrial Average acts "exhausted," that the best of the boom has probably been discounted, that the market is split by too many abnormal cross-currents and divergences.

The final answer will come from only one source—the market itself. I have stressed the point that we have now had a full correction of the February-March drop. If the two Averages can now work higher and ultimately better their February 9 peaks of 995.15 and 271.72, then the primary bull trend will be reconfirmed. In that case, we will have proof that the February-March sell-off was merely a reaction in a bull market. On the other hand, if one or both Averages fail to better the old highs, and they then turn down and violate the March 15 lows (911.08 and 243.60) it will constitute a primary bear signal. Such action would also be proof that we have been in a bear market since the February 9 highs. In that case, we would have to go back and reclassify the February-March decline as the first leg of a primary bear market, while the rise from the March lows would be reclassified as the first upward correction in a bear market.

Speculation continues rampant. One gauge of speculation is the ratio of volume on the (speculative) American Exchange to volume on the more staid N.Y.S.E. Over the past few weeks, Amex volume has exploded to the highest level in a generation with the ratio two weeks ago rising to 67%. "Normally," this ratio holds around 30%. A second interesting fact is that a few weeks ago a seat on the Amex sold for $100,000, highest price for an Amex seat in 35 years.

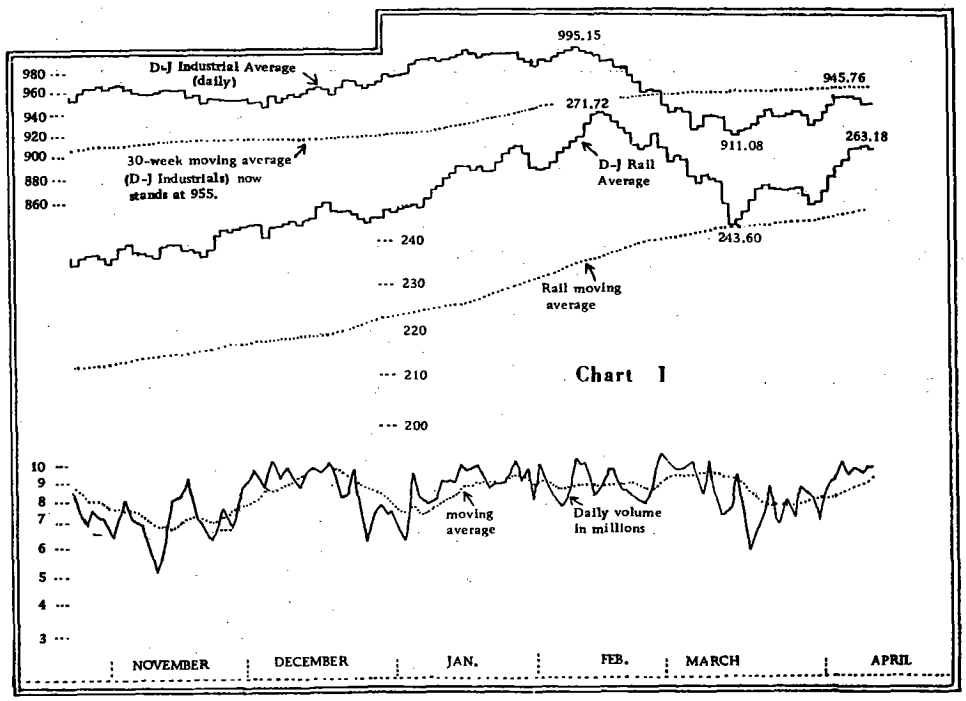
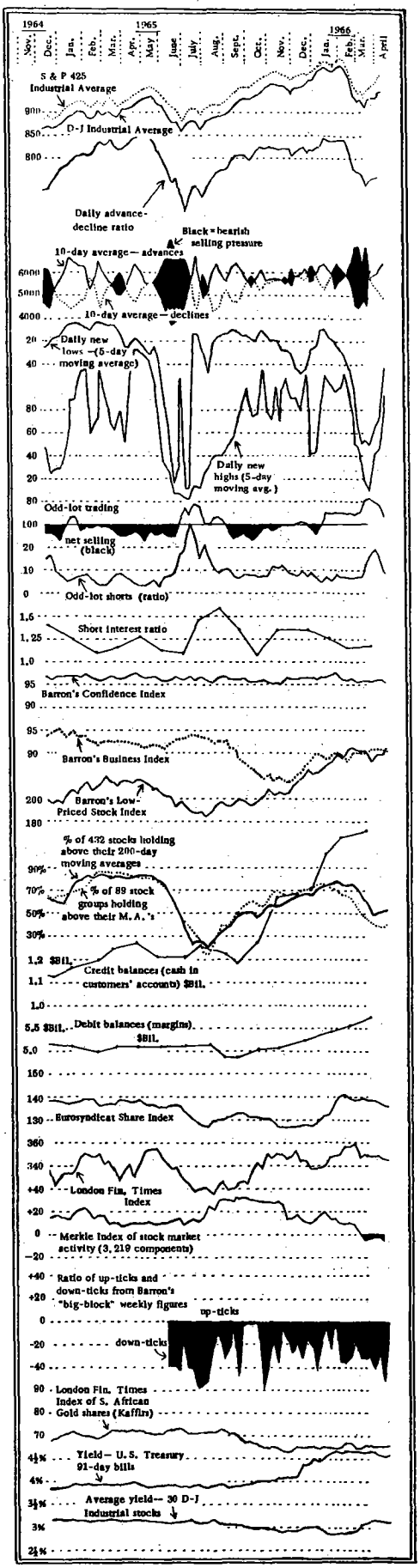
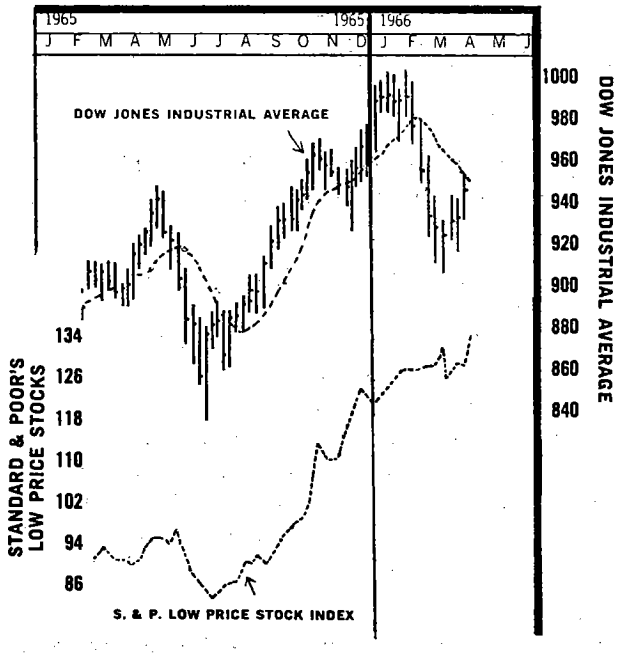


Chart I


1964
1965
1966
S & P 425 Industrial Average
D-J Industrial Average
Daily advance-decline ratio
Black = bearish selling pressure
10-day average—advances
10-day average—declines
Daily new lows (5-day moving average)
Daily new highs (5-day moving avg.)
Odd-lot trading
net selling (black)
Odd-lot shorts (ratio)
Short interest ratio
Barron's Confidence Index
Barron's Business Index
Barron's Low-Priced Stock Index
% of 432 stocks holding above their 200-day moving averages
% of 89 stock groups holding above their M.A.'s
Credit balances (cash in customers' accounts) $Bil.
Debit balances (margins) $Bil.
Eurosyndicat Share Index
London Fin. Times Index
Merkle Index of stock market activity (3,219 components)
Ratio of up-ticks and down-ticks from Barron's "big-block" weekly figures
up-ticks
down-ticks
London Fin. Times Index of S. African Gold shares (Kaffirs)
Yield—U.S. Treasury 91-day bills
Average yield—30 D-J Industrial stocks

Another extraordinary feature of the past few weeks was seen in the comparative action of the Industrial Average and the Low-Priced Stock Index. For the past 17 years or ever since the bull market started, the L-P Index and the DJI have always declined together whenever the Industrials reacted. But now, for the first time since 1949, we see the L-P Index (both Barron's and Standard & Poor's) at new highs while the Dow undergoes a reaction. I have included a chart (courtesy of Indicator Chart Service, Palisades Park, N.J.) which illustrates this highly abnormal situation. Note the rise in the L-P Index all through the Dow reaction period. Note the new high in the L-P Index set almost simultaneously with the low in the Dow. This chart is telling a dramatic story of wild speculation in the "cats-and-dogs" even while the investment-grade Dow stocks were in the midst of an 84 point drop and subsequent recovery.



I have included a listing of the "10 Most Active Stocks" for April 11. Here we see the incredible picture of wild speculation in electionic specialties while the only two Dow stocks on the list (Telephone and GM) are actually going down. Paste this little chart away in your scrapbook. I feel it will be something to show to your children some day ("My boy, this was what it was like back in '66").

Conclusion: The public and many speculators and funds are now playing "the numbers game." Stocks are being purchased because they are "breaking out" or going up. Investment-grade issues which led this market up for 17 years are being neglected. The situation is abnormal and dangerous. Nevertheless, we must consider the primary trend bullish as long as the Averages hold above their March lows. The final story will be told by way of a joint penetration of the two Averages above the February highs or below the March lows.

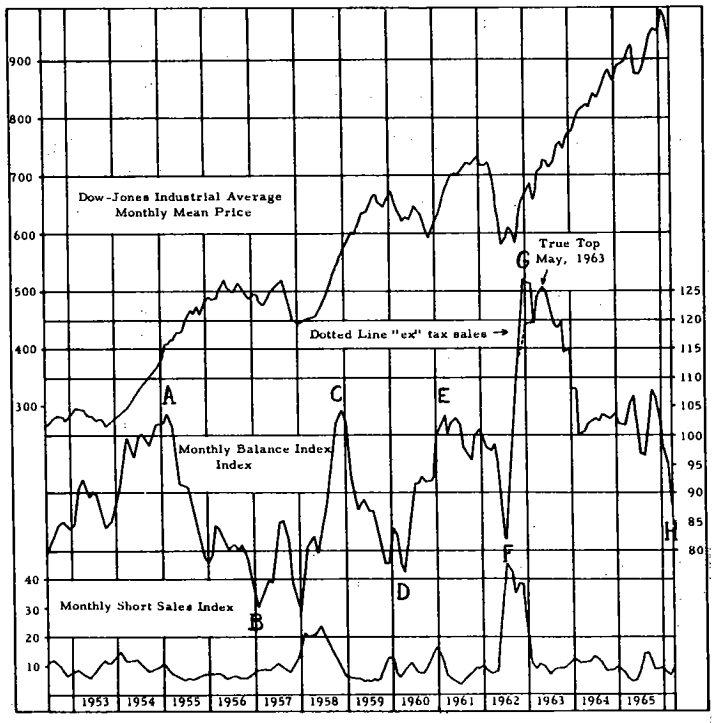
MOST ACTIVE STOCKS

NEW YORK (AP)—Sales, closing prices, net change in most active stocks

April 11, 1966	Total Sales	Last Sale	Net Change		Total Sales	Last Sale	Net Change
Std Kolls	133,700	38½	+5/8	East Air L	75,600	109	—1⅝
Transitron	115,900	20¾	+1	Alleg Cp	70,300	16½	+ ⅞
SCM Corp	108,300	73¾	+3⅜	Tran W Air	70,300	79⅜	—1
Raytheon	97,200	54⅛	+3⅞	Gen Motors	67,800	92⅞	— ⅞
Pack Bell	93,700	41	+5¼	Sperry Rd	63,600	20¾	— ⅛
Coml Solv	89,100	70⅝	—3⅝	Bunker Hill	60,800	39⅝	+3¼
Am Tel Tel	84,600	57¾	—1	TexGulf Sul	58,600	113⅜	—3⅛
Collins Rad	78,100	84¾	+3⅜				

ODD-LOTS: Odd-lot action is commented upon briefly in every mailing, but odd-lot action has now reached a point where I feel it is deserving of particular attention. I have borrowed a long-term chart of the odd-lot index from Mr. Garfield Drew (Drew Odd-lot Studies, 50 Congress St., Boston, Mass.). Mr. Drew originated these indices, and he also originated and developed the interpretation of the odd-lot indexes. Drew uses two broad odd-lot indexes, the daily buy-sell ratios (computed on a 10-day moving average) and the long-term or monthly buy-sell ratios (computed on a three-month moving average).

The accompanying chart illustrates the three-month moving average of the odd-lot ratios. This is, of course, a long-term view. When the index rises it means that odd-lotters are buying less (or selling more); when the index declines it means that odd-lotters are buying more (or selling less). Any figure over 100 indicates a net balance of selling over buying. Any figure under 100 indicates a net balance of buying over selling. It is very important to remember, however, that the critical factor in odd-lot interpretation is the change in odd-lot sentiment. The changes are much more important than the actual level of buying or selling at any given time. The changes in odd-lot sentiment are also always related to the direction of the market (in this case, the D-J Industrial Average). Normally, odd-lotters increase their buying as the market drops, while they decrease their buying as the market rises. The deviations from this normal behavior are most important in odd-lot interpretation.



A little history will serve to underscore the importance of the long-term odd-lot index. Like every other market study, it should be remembered that the odd-lot indexes are not a perfect device for catching tops and bottoms. The index tells us when we are approaching probable top (danger) areas or probable bottom (buying) areas. That is all experienced

market students can ask of any market study.

Note that at point "A" on the chart (1955) the index touched a peak (slight selling at this point), but that the direction of odd-lot sentiment then changed drastically, and odd-lotters switched to buying on an increasing scale. Normally, the odd-lot public tends to buy less on market advances, but here was a case of the public buying more as the 1955-56 advance continued. As such, the odd-lot index suggested that an important top was ahead. The real top in the Averages began forming in early 1956. The top lasted from April, 1956 to July, 1957. Between July, 1957 and October, 1957 the trouble came. The odd-lot index did not pin-point the exact top in the Dow; it merely identified the area, which, in retrospect, turned out to be a broad top.

In late 1958 ("C") another important switch in odd-lot sentiment occurred, and by mid-1959 the top began to form. The trouble was not seen in the Dow Industrials until January, 1960, although the advance-decline ratio and the low-priced index actually turned down early in 1959 (only a few months after the downturn in the odd-lot index).

Again in early 1961 ("E") the odd-lot index indicated a reversal in public sentiment and in retrospect we now know that almost all of the year 1961 represented distribution and resulted in the formation of a major top. The trouble came in 1962, and as seen on the chart (and this is quite characteristic) the odd-lotters increased buying through most of the drastic decline.

SUNDRY QUOTES AND NOTES: From the April 2 Economist (London): "The signs are that Switzerland is falling in behind France in its instransigent line on international reform." Dr. W. Schwegler, president of the Swiss National Bank (which is the country's monetary policy maker) took a firm stand against "artificial monetary reserves." Instead he urged all nations to "observe greater monetary and financial discipline." On international monetary reform, Dr. Schwegler stated that "It is urgent to wait." Thus, another powerful banking nation (besides France) has switched to emphasis on gold.

From U.S. News & World Report, April 2: "Europeans, in secret meetings with American officials, have strongly urged a U.S. tax increase." They fear that the boom will continue to pile up U.S. deficits. "Europeans made it clear in the meetings that the U.S. cannot count on Europe to finance continuing U.S. deficits in payments, even small ones. Surplus dollars in Europe growing out of payments deficits, the Europeans stated flatly, will be turned in for U.S. gold."

From the April 5 Janeway Letter by economist Elliot Janeway: "We make this point at length and with emphasis because we disagree with the general opinion that the worst is over for the bond market. One of our reasons for remaining bearish on the bond market— although by no means our only one— is that most current talk about it is going on in a purely domestic frame of reference. The unfavorable international pressures coming into play against the bond market argue that the outbreak of bullish sentiment is premature."

From James Reston, New York Times, April 3: "Washington is still counting on a cohesive Saigon government which does not exist; it cannot count on effective political or military action by the South Vietnamese, and it is not prepared to produce the political and military manpower to take their place. In short, the Administration has not adjusted to the facts. It has accepted the ends of the hawks— destruction of the enemy's forces— but not the means, and it has accepted the ends of the doves— a negotiated compromise— but not the means, negotiation with the Vietcong who are doing most of the fighting. So Washington is in trouble. It is relying on myths and the only consolation of the present political demonstrations is they are at least exposing the reality."

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"In recent weeks we have been shifting from short-term pessimism towards expectations of April strength and a spring rally." (From the April 8 Dines Letter).

"Right now the numbers and our feelings are in blissful harmony. We feel the market is headed for a new high and the numbers feel the same way." (From the April 8 Worden Tape Reading Studies).

"The D.S. Buy Signals received over the past few weeks indicate that the market is headed for significantly higher levels." (From the April 8 forecast from the Institute of Dynamic Synthesis).

"Bear trap snaps shut and bull market is resumed. On April 5 a major technical green light for the market was recorded. On that day the important advance-decline line emphatically bettered the March 28 reading and the upside breakthrough was bullishly accompanied by volume of 10.5 million shares." (From the April 7 Granville Market Letter).

"Recent market action confirms the probability cited last week— namely, that the March trading range represented the 'preparatory base for at least a reasonable degree of recovery' over the intermediate term. We still have long-term doubts, but for the time being it would be difficult to fault the market's behavior." (From the Drew Odd-lot Studies, April 9).

"The immediate trend of the market is once again bullish. This was signalled by the Disparity Index on March 24 and by the bullish percentage once again rising about 50%. Purchase of stocks showing good relative strength is once again warranted, althouth we have great doubt that one should take positions for the 6-month long capital gain period." (From the April 7 Chartcraft).

"How long can this blind buying and lop-sided bull market last? Nobody knows. But we do know that it isn't healthy, the bull in this rally is probably taking his last few gasps of breath, and one of these days he will fall over dead. The market is so unusual that it won't last much longer. In time, we will go back to what is normal again. It is entirely possible that we are already in the first false rally of a long primary bear market ahead which started at the Feb. 9 high closes." (From E. George Schaefer's Dow Theory Trader).

The 1962 crash was extraordinary in its severity, and it brought out a great amount of odd-lot bearishness as seen by the huge rise in the odd-lot index (toward selling) during the early part of the rise from 1962 lows. The peak of bearishness (the month of greatest selling) occurred in May, 1963. Selling eased into early 1964, but the market continued to advance. If this trend to less selling had continued it would have suggested gathering weakness, but during 1964 a new trend toward increased selling (as the market advanced) was seen. The peak of the new selling sentiment was reached by the three-month moving average in late 1965.

The action since late 1965 is significant. The monthly odd-lot ratio for March, 1966 was 83, the heaviest rate of buying for any month in almost four years. It is true that this buying was "normal" to some extent, since normally odd-lotters tend to buy on weakness ("lower prices are bargains"). But the March buying was heavier than the buying which occurred on comparable weakness during 1965. There is no question about it, odd-lotters are more bullish now than they have been at any time in recent years. The three-month moving average of the odd-lot index declined to 88 in March, 1966, and this is shown on the chart. Thus the three-month index shows more buying in the first quarter of 1966 than for any period since 1962.

Note that the move in the index from point G to H occurred in a three-step series. A trend toward buying from early 1963 to early 1964. A move toward less buying into late 1965. Then most recently a renewed trend to buying again. This giant downward zig-zag in the index has occurred in the past, and generally the second wave of sentiment toward buying is the one which identifies the beginning of the danger area and the beginning of the formation of a major top.

Conclusion: The pattern of the Industrial Average is beginning to take on a "ragged" appearance such as often occurs with the formation of a top (i.e., numerous violent declines and recoveries). In the face of this, odd-lotters are buying more than at any time since early 1962. Without trying to force a pin-point or precise "signal" out of Mr. Drew's long-term odd-lot studies, I believe that they are saying that we are now witnessing the formation of an important top.

50% PRINCIPLE: I have written extensively in the past about the 50% principle. This principle is based on the premise that the swings in the Industrial Average are much like the up-and-down swings of a child's see-saw. If one side of a see-saw is resting on the ground, and you push that side up it may rise to a slightly less than horizontal position, then come back to the ground on your side again. But if you push harder the see-saw may go past the horizontal position and your side of the see-saw will then rise all the way to the high position. In other words, it is important to note whether the momentum of the push can take the see-saw past the horizontal or halfway level. The same principle can often be applied with success to the market.

In Letter 318 (page 3) I noted that "At the March low of 911.08, Industrials had wiped out 54% of the entire gains of the last primary bull swing (the last bull swing was the movement from the June, 1965 low of 840.59 to the February, 1966 high of 995.15)." I felt that the fact that the Dow wiped out more than half of its previous major rise was unfavorable.

On the most recent recovery from the March low of 911.08, the Dow (so far) has advanced to an April 7 peak of 945.76 (see chart 1). This represented a recovery of only 41% or less than a halfway (50%) recovery of the ground lost during the February-March (995.15 to 911.08) decline. On April 11 the rally faltered and the Dow started down. The halfway mark of the March-April (911.08 to 945.76) recovery is 928.42. Therefore, I would say that any decisive penetration by Industrials through the 928.42 level would suggest a testing of the March low again (with a possible bear signal). Conversely, a persistent refusal to violate 928.42 could imply a further extension of the recovery.

WHAT D'YOU READ: Time Magazine, April 15: "For all the gnawing uncertainties of the situation in Vietnam, Washington's least harassed man last week seemed to be Lyndon Johnson. In and out of the White House, the President was trading quips with visitors, tugging elbows, wading into crowds for handshaking and abrazos. The President's prose matched his effulgent mood."

From Newsweek, April 18: "While South Vietnam's political caldron boiled on unpredictably, a haggard Lyndon Johnson boarded Air Force One and flew down to his Texas Ranch, determined to stay there through Easter week if possible .. Throughout the week, the President's watchful anxiety over the Vietnam crisis had been played down, even muffled. There was no mention of the late night and early morning meetings of the National Security Council, and White House statements said only that 'the President is keeping informed of the situation.' "

STOCKS: I continue to put stress on the D-J Industrial Average. This Average is indicative of the thinking of investment money, the money that ultimately makes or breaks the market. Most people do not realize the power represented by these 30 industrial giants, the componenets of the Average. But these 30 stocks represent one-third of the value of all the common stocks listed on the N.Y.S.E.

The fact is that the Industrial Average stocks are not looking well. For instance, six of the Dow stocks (duPont, Gen. Foods, Gen. Motors, Int. Paper, U.S. Steel and Woolworth) all made the new low list last Monday. Furthermore, of the 30 Dow stocks I count 21 which are now within a few points of their low for the year. This is rather ominous, and it does not portend well for the market despite the frenzied speculation in lesser "growth" or "specialty" issues.

In this Letter and coming Letters I feel that it is important to show subscribers actual charts of the 30 Dow stocks. The first 9 (in alphabetical order) are herewith included. Note that of the first 9, only Alcoa and Anaconda are bullishly situated. The other 7 are breaking down and at or near lows for the year. Allied and Beth. Steel are back to the 1963 levels, while duPont and Telephone are back to the 1962 levels. This is, all in all, a rather shocking picture.

Charts at right are courtesy of Quote Digest, 110 N. Lorraine, Wichita, Kansas.